OP-ED COLUMNIST

Rubin Gets Shrill

By PAUL KRUGMAN

Published: January 6, 2004

Argentina retained the confidence of international investors almost to the end of the 1990's. Analysts shrugged off its large budget and trade deficits; business-friendly, free-market policies would, they insisted, allow the country to grow out of all that. But when confidence collapsed, that optimism proved foolish. Argentina, once a showpiece for the new world order, quickly became a byword for economic catastrophe.

So what? Those of us who have suggested that the irresponsibility of recent American policy may produce a similar disaster have been dismissed as shrill, even hysterical. (Hey, the market's up, isn't it?) But few would describe Robert Rubin, the legendary former Treasury secretary, as hysterical: his ability to stay calm in the face of crises, and reassure the markets, was his greatest asset. And Mr. Rubin has formally joined the coalition of the shrill.

In a paper presented over the weekend at the meeting of the American Economic Association, Mr. Rubin and his co-authors — Peter Orszag of the Brookings Institution and Allan Sinai of Decision Economics — argue along lines that will be familiar to regular readers of this column. The United States, they point out, is currently running very large budget and trade deficits. Official projections that this deficit will decline over time aren't based on "credible assumptions." Realistic projections show a huge buildup of debt over the next decade, which will accelerate once the baby boomers retire in large numbers.

All of this is conventional stuff, if anathema to administration apologists, who insist, in flat defiance of the facts, that they have a "plan" to cut the deficit in half. What's new is what Mr. Rubin and his co-authors say about the consequences. Rather than focusing on the gradual harm inflicted by deficits, they highlight the potential for catastrophe.

"Substantial ongoing deficits," they warn, "may severely and adversely affect expectations and confidence, which in turn can generate a self-reinforcing negative cycle among the underlying fiscal deficit, financial markets, and the real economy. . . . The potential costs and fallout from such fiscal and financial disarray provide perhaps the strongest motivation for avoiding substantial, ongoing budget deficits." In other words, do cry for us, Argentina: we may be heading down the same road.

Lest readers think that the most celebrated Treasury secretary since Alexander Hamilton has flipped his lid, the paper rather mischievously quotes at length from an earlier paper by Laurence Ball and N. Gregory Mankiw, who make a similar point. Mr. Mankiw is now the chairman of the president's Council of Economic Advisers, a job that requires him to support his boss's policies, and reassure the public that the budget deficit produced by those policies is manageable and not really a problem.

But here's what he wrote back in 1995, at a time when the federal deficit was much smaller than it is today, and headed down, not up: the risk of a crisis of confidence "may be the most important reason for seeking to reduce budget deficits. . . . As countries increase their debt, they wander into unfamiliar territory in which hard landings may lurk. If policymakers are prudent, they will not take the chance of learning what hard landings in [advanced] countries are really like."

The point made by Mr. Rubin now, and by Mr. Mankiw when he was a free agent, is that the traditional immunity of advanced countries like America to third-world-style financial crises isn't a birthright. Financial markets give us the benefit of the doubt only because they believe in our political maturity — in the willingness of our leaders to do what is necessary to rein in deficits, paying a political cost if necessary. And in the past that belief has been justified. Even Ronald Reagan raised taxes when the budget deficit soared.

But do we still have that kind of maturity? Here's the opening sentence of a recent New York Times article on the administration's budget plans: "Facing a record budget deficit, Bush administration officials say they have drafted an election-year budget that will rein in the growth of domestic spending without alienating politically influential constituencies." Needless to say, the proposed spending cuts — focused only on the powerless — are both cruel and trivial.

If this kind of fecklessness goes on, investors will eventually conclude that America has turned into a third world country, and start to treat it like one. And the results for the U.S. economy won't be pretty.

RELATED ARTICLES

- Economic Memo; In Big Picture, Winter Misery Faded Quickly (October 31, 2003) $
- White House Takes Credit For Surge In Economy (October 31, 2003) $
- A Slowing Stream of New Jobs Gives a Full Picture of a Slump (October 1, 2003) $
- Bush Defends Tax Cuts and Announces Jobs Post (September 2, 2003) $

Find more results for United States Economy and Recession and Depression

TOP OPINION ARTICLES

- Islamic Democracy
- 'Busting Chops' in the Firehouse
- The New Queen
- Ready to Roll on Mars

Go to Opinion